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THE TREATMENT OF STUDENT LOAN FORGIVENESS UNDER THE INCOME TAX ACT

The Biden-Harris Administration's Student Debt Relief Plan authorizes a one-time forgiveness of up to $20,000 in student loans held by the U.S. Department of Education.[1] This special loan forgiveness will not result in any additional federal income tax for borrowers, as the American Rescue Plan Act (ARPA) amended Section 108(f)(5) of the Internal Revenue Code (IRC) to exclude from the borrower's adjusted gross income (AGI) certain student loans forgiven between 2021 through 2025.[2] While recipients of this relief will therefore not incur any additional federal income tax under this program, questions have been raised all across the country about whether the same holds true for state and local income tax purposes.

Department's Note: The student loan forgiveness program has been subject to ongoing legal challenges. Treasury is monitoring developments in this area and will issue further updates to taxpayers, as necessary, pending the outcome of these challenges.

In this regard, the answer generally lies within the degree of each state's conformity to the exclusion codified within IRC 108(f)(5). In a state which automatically conforms to the version of the IRC in effect for each tax year (i.e., a so-called "rolling conformity" state), that state is likely to conform to a version of the IRC that includes IRC 108(f)(5). In these states, there will not generally be any state income tax liability for loans forgiven through this program[3] without special provisions decoupling from IRC 108(f)(5) within that state.[4] Conversely, in a state which conforms to a version of the IRC only as of a specific date (i.e., a so-called "static conformity" state), that state's treatment of forgiven loans will likely depend on the conformity date that is used. Forgiven loans may be subject to tax in states where the conformity date precedes ARPA's enactment of IRC 108(f)(5).[5]

In Michigan, most individuals apply the provisions of the IRC in effect for the tax year when filing their Michigan individual income tax return. Indeed, the taxable income of an individual in Michigan begins with their "adjusted gross income (AGI) *as defined in the internal revenue code*."[6] The term "internal revenue code" is defined to generally refer to the version of the code in

[1] For more information, see https://studentaid.gov/manage-loans/forgiveness-cancellation/debt-relief-info.

[2] PL 117-2.

[3] See e.g., Ohio (ORC 5747.01(A)).

[4] See e.g., Indiana (IC 6-3-1-3.5(a)(30) (requiring amounts excluded under IRC 108(f)(5) to be added to the tax base).

[5] See e.g., Wisconsin (Wis Stat § 71.01(6)(m)1).

[6] MCL 206.30(1).

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effect for that same tax year.[7] The tax base of an individual in Michigan therefore automatically conforms to federal AGI as determined under a version of the IRC that includes IRC 108(f)(5). Because there are no decoupling provisions for loan forgiveness under the Income Tax Act, forgiven student loans will not be included in Michigan taxable income. Thus, this one-time student loan forgiveness will not be subject to tax in Michigan.

However, taxpayers may still need to keep track of forgiven loan amounts for other purposes. Indeed, as used most commonly in computing the homestead property tax credit and the home heating credit, the "total household resources" (THR) of an individual is defined to include that individual's federal AGI "plus all income specifically excluded or exempt from the computations of the federal adjusted gross income."[8] Because student loans are specifically excluded from federal AGI through IRC 108(f)(5), those amounts are statutorily required to be included in that claimant's THR in Michigan. Taxpayers should retain sufficient records of the forgiven loan amounts in calculating THR.

Any additional updates and guidance related to student loan forgiveness will be posted on Treasury's website, www.michigan.gov/taxes.

[7] MCL 206.12(3).

[8] MCL 206.510(1).

RECENTLY ISSUED GUIDANCE FROM TREASURY

Revenue Administrative Bulletins

RAB 2022-16 Updating RAB 2021-8's Interpretation of the Manufacturer Carve-out Language of 2020 PA 326 in Response to the Passage of 2022 PA 171 (Approved October 25, 2022)

RAB 2022-17 "Tax on the Difference"- Excluding the Value of Certain Trade-Ins From the Total Amount of Consideration When Determining "Sale Price" (Approved October 25, 2022)

RAB 2022-19 Sales and Use Tax Exemption Claims Procedures and Format (Approved Nov 1, 2022)

Notices

- Notice Regarding the Implementation of 2022 Public Act 148, Issued August 26, 2022
- Student Loan Forgiveness Not Subject to Income Tax in Michigan, Issued September 28, 2022
- Tax Rate Calculation on Gross Premiums Attributable to Qualified Health Plans for Tax Year 2022, Issued September 30, 2022
- The Hearings Division Announces the Michigan Department of Treasury Hearings Taxpayer Portal, Issued October 24, 2022

SUPREME COURT DENIES TREASURY'S MOTION FOR REHEARING COMERICA INC V DEP'T OF TREASURY

On September 21, 2022, the Michigan Supreme Court denied Treasury's motion for rehearing in *Comerica Inc v Dept of Treasury*, previously reported in the August 2022 issue of Treasury Update. The denial leaves intact the previously affirmed decision of the Court of Appeals that a merger between two financial institutions allows certain Single Business Tax (SBT) credits to transfer by operation of law (the Banking Code).

RULING THAT REVERSE VENDING MACHINES DO NOT QUALIFY FOR THE INDUSTRIAL PROCESSING EXEMPTIONS BECOMES FINAL WORD

As explained in the August 2022 issue of the Treasury Update, the Michigan Court of Appeals recently held, in *TOMRA of North America v Dep't of Treasury*, that reverse vending machines (and related repair parts) do not qualify for the "industrial processing" exemption under either the General Sales Tax Act (MCL 205.54t) or the Use Tax Act (MCL 205.94o). As the time for seeking leave to the Michigan Supreme Court has passed, the Court of Appeals' published opinion is the final word from the Michigan courts in this matter.

ABOUT TREASURY UPDATE

Treasury Update is a periodic publication of the Tax Policy Division of the Michigan Department of Treasury.

It is distributed for general information purposes only and discusses topics of broad applicability. It is not intended to constitute legal, tax or other advice. For information or advice regarding your specific tax situation, contact your tax professional.

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MICHIGAN ENACTS NEW PARTNERSHIP REPORTING LEGISLATION

PA 148 of 2022, signed into law on July 19, 2022, introduced Chapter 18 in Part 3 of the Income Tax Act to create a new way for certain partnerships to report federal adjustments that impact the Michigan income tax liability of its partners. This article discusses the background of this legislation and highlights the important reporting features within Chapter 18.

PA 148 is responsive to modifications to the reporting of adjustments by partnerships at the federal level. The Bipartisan Budget Act (BBA) of 2015 modified partnership reporting procedures to permit the assessment and collection of tax directly from the partnership rather than through each separate partner. This so-called BBA Centralized Partnership Audit Reporting Regime[1] applies both to adjustments determined by the Internal Revenue Service (IRS) through a partnership audit and adjustments self-determined by a partnership through the filing of an administrative adjustments request. The centralized method of reporting is intended to streamline the reporting of federal tax adjustments for certain partnerships which, although subject to various partnership-level elections, will generally be used by large partnerships with greater than 100 partners. In these cases, the centralized collection of tax eliminates the need for partners to file amended federal income tax returns.

Without an amended federal income tax return filed by the partner, adjustments were necessary under the Income Tax Act to ensure that the partner's share of any adjustments is reported for Michigan income tax purposes. For this reason, Chapter 18 provides that federal adjustments that are reported under the BBA Centralized Partnership Audit Regime are required to be reported by the partnership through one of two distinct methods:

1. *The "Push Out" method.* The "Push Out" method requires — within 90 days of the "final determination date" — that the partnership report the distributive share of federal adjustments to Treasury and to each of its partners from the reviewed year. Except for those partners who participated on a composite return, each partner must separately report their share of the adjustments and either pay the additional Michigan income tax or claim any additional refund, as applicable. The report from the partner under the "Push Out" method must be filed no later than 180 days after the "final determination date." Accordingly, the "Push Out" method requires that the relevant federal adjustments be communicated by the partnership to all partners so that each partner can separately report their respective share of those adjustments in Michigan.
2. *The "Pay Up" method.* In lieu of the "Push Out" method, the "Pay Up" method allows a partnership to make an affirmative election to pay the tax or claim a refund on behalf of all of its partners. The election — which subjects the partnership to all laws related to reporting, assessment, payment, and collection of tax in Michigan — is required to be made within 90 days of the "final determination date." Thereafter, within 180 days of that date, that partnership must report and pay the tax owed[2] or claim the refund due on behalf of its direct or indirect partners for the reviewed year. Any report, payment, or refund claim made by a partnership under the "Pay Up" method will satisfy the reporting obligations of its partners; partner-level reports or payments are not permitted when this election has been made. In other words, the "Pay Up" method effectively provides for a centralized method of reporting the Michigan tax related to partnership adjustments.

The timeliness of all elections, filings, and payments under Chapter 18 is determined by reference to the "final determination date." The "final determination date" is generally dependent on the source of the federal adjustment. For example, the "final determination date" of an IRS-initiated partnership audit will refer to the first day on which no federal adjustment arising from the audit remains to be finally determined, including the period of any subsequent appeal. In contrast, the "final determination date" of a self-reported administrative adjustment request refers to the date on which that request was filed with the IRS. Partnerships will need to establish the appropriate "final determination date" to determine the timeliness of their reporting obligations under Chapter 18.

The "Push Out" or "Pay Up" methods each have important consequences for both the partnership and its partners and, in this regard, the decision to use either method can only be made by the "state partnership representative." The state partnership representative refers to the person vested with sole authority to act on behalf of the partnership under Chapter 18. While the partnership may designate an alternate person, this will ordinarily be the same individual who was designated to serve as the partnership's federal partnership representative for federal income tax purposes. Any actions of the state partnership representative under Chapter 18 will be legally binding upon both the partnership and all of its direct and indirect partners.

Consistent with the implementation of the BBA Centralized Partnership Audit Regime, PA 148 is retroactive to tax years beginning on or after January 1, 2018. Treasury is developing the forms, systems, and guidance necessary to administer the program, with initial reporting and payment functionality expected January 1, 2023. To accommodate this implementation period, Treasury published a notice on August 26, 2022, explaining that all reporting, payment, and election deadlines under Chapter 18 will begin effective January 1, 2023, for any partnership that may otherwise be required to report an adjustment before that date.

Taxpayers are encouraged to check Treasury's website for additional updates in the future regarding the implementation of Chapter 18. Future updates and guidance will be posted to www.michigan.gov/taxes.

[1] For more information, see https://www.irs.gov/businesses/partnerships/bba-centralized-partnership-audit-regime.

[2] For details on the calculation of the tax, see MCL 206.723(4).

COURT OF CLAIMS: "FIELD CHARGES" NOT PROPERLY INCLUDED IN MBT INVENTORY DEDUCTION

In *E I Du Pont De Nemours & Co v Dep't of Treasury* (Docket No. 21-000174-MT), issued October 7, 2022, the Court of Claims held that certain labor and service charges were not properly included in Plaintiff's claimed purchases from other firms inventory deduction. At issue in the case was whether Treasury correctly denied Plaintiff's claimed deduction for "field charges" Plaintiff paid to farmers to produce Plaintiff's child seed inventory.

Following an audit of Plaintiff's 2008-2011 MBT tax years and an informal conference, Treasury determined that Plaintiff correctly deducted as inventory the price it paid its farmers for the purchase of child seeds (seeds produced for resale from plants grown using Plaintiff's "parent seeds"), including certain premium and bonus payments, but improperly deducted related labor and service charges ("field charges"). Plaintiff sued in the Court of Claims. As framed by the court, Plaintiff argued that "[Treasury misunderstood Plaintiff's] grower contracts, which Plaintiff claimed do not establish a fixed price for the seeds, but require plaintiff to pay the growers based on 'multiple mathematical equations that account for volume and quality-based variables.'" Both parties moved for summary disposition.

The court granted Treasury's motion and denied Plaintiff's motion, finding that Plaintiff's contracts with its farmers and its general ledger entries did not support Plaintiff's claim that the field charges were incorporated into the total price of the child seeds.

Regarding the contracts, the court stated:

> Nowhere in the contract language is there any express (or even implied) language that the labor and services are incorporated in the price for the seed inventory. In fact, the contracts are completely silent on how the parties would address payment for labor or other services. Plaintiff and the growers could have structured payment in a way that the field charges were expressly incorporated in the inventory, but they chose not to do so.

Regarding Plaintiff's general ledger entries, the court stated:

> Plaintiff included separate line items on its original general ledger for "field," "plowing," and "spraying" charges. Plaintiff concedes that it "may have indicated that [the general ledger] includes field charges during the audit" but claims that those entries were made in error….But even if plaintiff now believes the entries were made "in error," the fact remains that plaintiff separated the service charges from the tangible property (the child seeds) in its original business records and as part of its process for paying its growers. The field charges, therefore, were not a "stock of goods" as required to take an inventory deduction under the MBTA.

The court further noted that Plaintiff's witness confirmed during his deposition that "the field charges were *not* tangible personal property, but reflected services performed in connection with obtaining a successful crop." While Plaintiff subsequently provided affidavits intended to counter that deposition testimony, the court found such affidavits ineffective, stating

> "[P]arties may not contrive factual issues merely by asserting the contrary in an affidavit after having given damaging testimony in a deposition[.]" Kaufman & Payton PC v Nikkila, 200 Mich App 250, 256-257; 503 NW2d 728 (1993). Accordingly, plaintiff cannot use Leming's and Dummermuth's affidavits to contradict plaintiff's general ledger and Dummermuth's deposition testimony.

The court went on to explain:

> Moreover, if plaintiff's theory were accurate, then plaintiff would not need to delineate separately the service charges on its general ledger. In fact, plaintiff does not attempt to connect the field charges to any specific grower contract. Plaintiff's argument that it "does not pay the growers for specific services rendered in connection with producing child seeds under its grower contracts" is undermined by its general ledger, which separately delineated the items and assigned them separate charges. To put it more plainly, plaintiff's argument that the field charges were incorporated into the total cost of the child seeds is contradicted by its own representative's testimony and its business records. Plaintiff could have structured its contractual relationships with the growers in such a way that the field charges were incorporated into the price for the inventory, and plaintiff could have taken a completely "hands-off" approach to the growers' operations. But plaintiff chose to be much more involved in the day-to-day operations of its growers, and plaintiff's general ledger reflects that it paid the growers separately for their labor and services. For these reasons, the Court agrees with defendant that the field charges were not subject to the inventory deduction under the MBTA.

On October 28, Plaintiff filed a motion for reconsideration.